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By online submission to IFRS

Re: Sustainability and Climate-related Disclosure Standards, Exposure Drafts

Dear Mr. Faber and Ms. Lloyd,

Thank you for the opportunity to comment on the International Sustainability Standards Board (ISSB) Exposure Draft (ED) IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information (S1) and Exposure Draft IFRS S2 Climate-related Disclosures (S2).

The Asian Corporate Governance Association (ACGA) is a non-profit membership association founded in Hong Kong in 1999. We conduct independent research on corporate governance and related ESG topics, and advocate at the regulatory and corporate level across Asia to improve standards and practices. ACGA is entirely funded by a network of more than 110 member firms, of which 80% are institutional investors with more than US$40 trillion in assets under management globally.

We view these proposed standards as a solid first step in a long journey towards integrating sustainability principles into the fabric of enterprise decision-making and operation, and fully support the vision of designing standards that can serve as a global baseline and be adopted in any jurisdiction around the world.

The integration and consolidation of the previous existing sustainability reporting frameworks such as the Task Force on Climate-Related Financial Disclosures (TCFD) and Sustainability Accounting Standards Board (SASB) into one coherent whole is an endeavour we are pleased to see. We would like to express our appreciation for the speed with which these Exposure Drafts have been released. We support the decision to organise the standards around the TCFD framework. The emphasis on the SASB-informed industry-specific standards is welcome, as well as adopting the SASB approach of gearing standards towards meeting the needs of the users of financial statements. For the purposes of the new ISSB standards we also support the approach of defining materiality in terms of enterprise value, while recognizing the broader importance of non-financial disclosures on impact or “double materiality” that may be added via a building blocks approach based on standards such as the Global Reporting Initiative (GRI) or local ESG reporting guidelines in different markets.

In addition, we agree with requiring that these financially relevant sustainability disclosures made under the proposed ISSB standards be released at the same time as a reporting entity’s other annual

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reports and financial statements. We further support aligning that disclosure with the related financial statements and ensuring they both cover the same entities to enhance connectivity and comparability. Requiring narrative explanation of the connectivity between sustainability-related disclosure and the financials is another welcome proposal.

We offer some high-level comments and suggestions below. We believe the standards in these Exposure Drafts will serve as an appropriate starting point for a global standard. While we recognize the need for urgency, we hope that the issues highlighted will be resolved before promulgation.

General Comments

Definitions

There are a number of key terms used in the EDs that would benefit from clearer definitions. Most importantly is the term "sustainability" which is not defined in the S1 ED. Because S1 is the foundation for all future standards, and because the standards are principle-based and refer repeatedly to the concept of "sustainability", it is important that this term be defined.

There are two definitions of sustainability in common use:

1 - the ability to be maintained at a certain rate or level, as in:

"the sustainability of economic growth" or "the sustainability of the enterprise"

2 - avoidance of the depletion of natural resources in order to maintain an ecological balance; often expanded to include general environmental, social or governance issues with an eye to ensuring the sustainability of human society.

The S1 standard implicitly combines these definitions by asking reporting entities to consider issues from the second definition to ensure the viability of the entity under the first definition. This is quite different from the conceptualisation of "sustainability" that some entities may hold. The standard could more explicitly state that what is being asked of entities is to assess the sustainability of the enterprise (definition 1, continuity) through the lens of sustainability dimensions (definition 2, ecologically/ESG) such as disruptions in the availability of natural resources or other resources.

A second term that would benefit from clearer definition is "significant". This word appears throughout the two EDs and is usually attached to passages that have required someone to make a decision (ie, the standards "require an entity to disclose information about its significant sustainability-related risks and opportunities"). Without a clearer definition or guidance on this word, it may be difficult for decision-makers and auditors or assurers to assess whether that standard has been met. If the intention of the standard setters is that this word be interchangeable with "material", which we would support, then that should be made clear.

Guidance

The EDs as they stand now draw on a wealth of experience and resources already developed by entities such as TCFD, SASB and the Climate Disclosure Standards Board (CDSB), which we support. However, while those materials are certainly helpful, the current language in the ED standards referencing each of them could be confusing as one of the intentions of creating ISSB was to simplify the reporting landscape into a single coherent standard for reporting entities to follow. Reporting entities have long been concerned that it is difficult to make sense of so many disparate standards and the language in the EDs and guidance have not yet simplified their task. We hope that this will be resolved in time as more of those existing approaches are absorbed into ISSB and future standards are released.

Much of the language in the standards seems to assume the reader is already familiar with the topic, which for a new global baseline standard is unlikely to be a fair assumption. Sustainability reporting across much of Asia, the region we cover, is still in its infancy. And the bulk of this reporting falls into the non-financial category. The focus in ISSB on sustainability- and climate-related financial information, combined with the required auditing of such information in financial statements, is new. Indeed, there seems to be little recognition in the region that existing IFRS accounting standards and ISA auditing standards should already be applied to material climate-related risks, as highlighted by the IFRS Foundation and International Auditing and Assurance Standards Board in late 2020.

We expect that clearer guidance will be provided to increase the accessibility of the standards, as well as the comparability of disclosures across jurisdictions. There is much discussion in the questions on the EDs about the costs to reporting entities. We believe that clearer guidance would help to reduce those costs, not only in terms of the preparation of reports but also in terms of auditing.

Timing and new reporters

On the subject of costs and inexperienced reporting entities, there are a number of questions in the EDs relating to this topic:

- Effective dates for S1 and S2
- Scope 3 emission disclosure for all entities
- Scenario analysis for all entities

Traditionally, when it comes to implementing new governance or reporting standards, a common approach in many markets is to require tougher standards for larger players earlier and use their influence to encourage smaller players to adopt the standards or require compliance among smaller players at a later date. We believe that this approach may not be suitable for the new ISSB standards for several reasons, but primarily because the information from smaller entities is needed to reliably complete disclosures for larger entities.

Scenario analysis for all as soon as possible

Scenario analysis is the methodology that is most likely to help smaller players become aware of the climate-related risks lurking around the corner. It is also one that is most likely to help them gain the skills and understanding to be able to fulfil the broader disclosure requirements set by the ISSB EDs. Delaying scenario analysis and allowing for alternatives such as qualitative analysis or sensitivity analysis may not do these reporters any favours. In addition, the process is described as an “iterative learning process, and may take multiple planning cycles to achieve”. Because it will take a long time to get right, we recommend that all reporting entities be encouraged to start as early as possible. At the same time, we think there should be tolerance at the jurisdictional level in the early stages, perhaps via safe harbours or grace periods, for less-than-perfect scenario analysis disclosures.

Large entities need data from small entities

Another reason we support all entities adopting scenario analysis early on is that the insights uncovered through the process by smaller enterprises will be important for informing the disclosures prepared by larger enterprises. The EDs require reporting entities to understand and disclose on the risks throughout their value chain. If smaller entities (including unlisted entities) have not done their homework, so to speak, the validity and integrity of the disclosures by any entity will be weakened.

Scope 1 and 2 for all as soon as possible

This carries through to our views on Scope 3 greenhouse gas (GHG) emissions. Rather than asking whether all entities should report on Scope 3 right now, we think a more useful approach for jurisdictions to take would be to first focus on accurate disclosure of Scope 1 and Scope 2 emissions for all entities, large and small, listed and unlisted. This is because they form the basis for Scope 3 for other entities in the value chain. Once those Scope 1 and 2 figures are clear and reliable, they can be rolled into the Scope 3 analysis and disclosures of larger entities at little increased cost to them. This frees preparers to focus on unmeasured downstream Scope 3 emissions, particularly for end users.

Scope 3 and its difficulties

As ISSB states in its Basis for Conclusions: "The difficulties inherent in the comparability, coverage, transparency and reliability of Scope 3 GHG emissions data is recognized". We feel it is not necessary to go into the details of the problems with Scope 3 here, but would urge preparers to provide as much transparency as possible with respect to data sources and assumptions used. While we broadly support disclosure of Scope 3 emissions under the GHG Protocol, we would also note that there is substantial appetite from various quarters for a better way.

In future iterations of S2, we encourage standard setters to take note of the so-called “E-liabilities” approach as a possible addition or solution. The approach uses well-established activity-based costing methods and applies them to carbon emissions. Instead of assessing the “value add” at each step of the value chain, carbon emissions are conceptualised as a “liability add” carried along each step of production. Readers can learn more about the approach here in the original November/December 2021 Harvard Business Review article (https://hbr.org/2021/11/accounting-for-climate-change) and an updated article April 2022 (https://hbr.org/2022/04/we-need-better-carbon-accounting-heres-how-to-get-there). We observe that the value of the E-liabilities approach could best be unlocked through improved Scope 1 and 2 emissions disclosure across the value chain, and so encourage efforts towards this goal.

We hasten to add here that we recognize that there is 20 years of experience and consensus-building already invested in the GHG Protocol approach and we support its continued use. We do not wish to derail the process toward adoption of the ISSB standards nor upend the current consensus. Rather, we see the value of the E-liabilities approach and encourage the standard setters to consider how it might be integrated into existing systems in future.

Compliance

We have serious concerns about the language in Paragraphs 62 and 92 of the S1 ED which proposes allowing entities who may be prohibited by local law from disclosing information required by an IFRS Sustainability Disclosure Standard to still assert compliance with those standards. We see considerable scope for misinformation here.

In our view only reporting entities whose sustainability-related financial disclosures comply with all of the relevant requirements of IFRS Sustainability Disclosure Standards should be able to include an explicit and unqualified statement of compliance. Entities that do not meet all the standards should clearly state which requirements were not met and why. They would then be permitted to assert partial compliance with the standards.

On balance, however, we consider the S1 and S2 Exposure Drafts to be a strong start towards the development of a global baseline and global standard for sustainability-related financial disclosure. We would be happy to discuss any of the points in our letter further with you.

Yours sincerely,

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**Vivian Yau, Research Manager, Market Analytics, assisted with this submission.*